



Massachusetts Division of  
Health Care Finance and Policy

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Commissioner

# ANALYSIS IN BRIEF

## Financial Stability of Community Health Centers

Community health centers (CHCs) are not-for-profit, community-based organizations that provide comprehensive primary and preventive health care and social services to medically underserved individuals and families regardless of their ability to pay.<sup>1</sup> CHCs provide an invaluable service to low income and underserved populations throughout the Commonwealth of Massachusetts. Because of the severe financial distress that many CHCs have suffered in the recent past and the danger of losing some of these crucial providers, the financial health of the CHCs within the Commonwealth must be closely monitored.

### Financing

As an industry, CHCs rely heavily on grant dollars for their fiscal survival and generally operate at the margin. This means that CHCs are generally just able to cover their expenses from the revenue they generate and as a result are very vulnerable to changes in financial stability.

Operating and total margins, liquidity, and cash flow indicators are generally used to assess the financial health of an industry. Depending on the specific industry, there may exist standard levels for various indicators that are considered minimum or maximum acceptable values. For CHCs these standards are not readily available. However, an analysis of relevant financial indicators over time may be used as a standard against which changes in financial stability at a given point in time can be measured.

### Data Source

The data presented here are based on the audited financial statements and cost reports of 33 out of 35 freestanding<sup>2</sup> CHCs in Massachusetts. The financial data for these freestanding CHCs are submitted to the Division of Health Care

Finance and Policy on an annual basis. This analysis is based on five years of financial data from FY94 through FY99. There are a number of CHCs throughout Massachusetts which are hospital-based rather than freestanding. These CHCs are not included in this analysis.

### Profitability

An operating margin is the ratio of operating income to total revenue. The total margin extends the operating margin to account for all net income including non-operating income such as investments and sale of assets. A negative margin in either category indicates financial trouble with negative operating margins usually appearing as the first sign of financial difficulty. Negative operating and total margin together show a loss on investments as well as losses from simply providing services to patients. Over time, negative margins also cause further financial problems with liquidity and coverage of debt obligations.

CHCs had relatively low operating margins ranging from 0.3% to 1.4% during the FY94 to FY99 period (see Figure 1 on page 2). While it is not surprising that the CHCs had low operating margins, the fact that they have decreased significantly since FY94 should be noted.

Median operating margin decreased from 1.4% in FY94 to 0.3% in FY96. Another decrease was seen in FY98 (0.4% down from 0.8% in FY97). In FY99, median operating margin increased slightly to 0.8%.

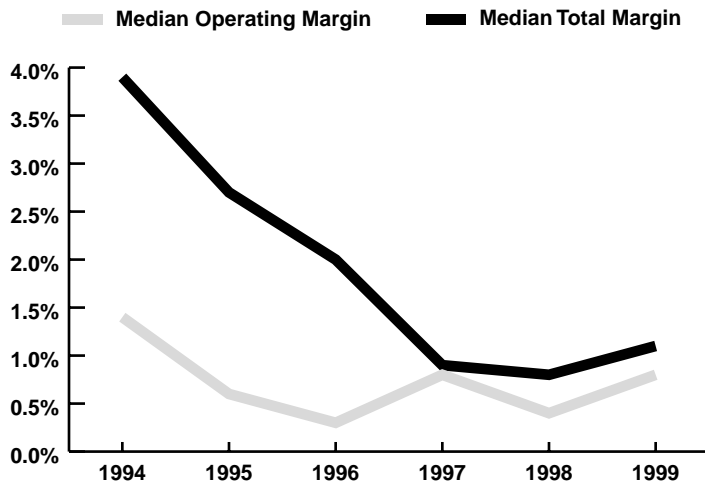
In FY94, 22% of CHCs had negative operating margins. A high of 50% of CHCs had negative operating margins in FY95. In FY99, nearly 40% of CHCs were still experiencing negative operating margins.

Median total margin decreased from 3.9% in FY94 to 0.9% in FY97 (see Figure 1 on page 2). Median total margin appears to have stabilized

following this drop. From FY94 to FY97, the percentage of CHCs experiencing negative total

In addition, because of the populations they serve, CHCs rely heavily on grant revenue—both restricted and unrestricted—for their survival. In 2000, the Division of Health Care Finance and Policy conducted a survey of most Massachusetts CHCs. This survey showed that on average, community health centers received approximately 37% of their total revenue from grants (see Figure 3 on page 3).<sup>3</sup>

**Figure 1: Median Total and Operating Margins for Freestanding Massachusetts CHCs (FY94 - FY99)**



margins increased from 11% in FY94 to 22% by FY97. In FY98, this number jumped to 40% and for FY99 decreased slightly to 32%.

For the most part, from FY97 to FY99, the same CHCs experiencing negative operating margins were also suffering from negative total margins. This indicates that they were unable to salvage positive total margins with non-operating revenue. Prior to FY97, many of the community health centers experiencing negative operating margins were able to salvage positive total margins with non-operating revenue (capital contributions, investment and other income).

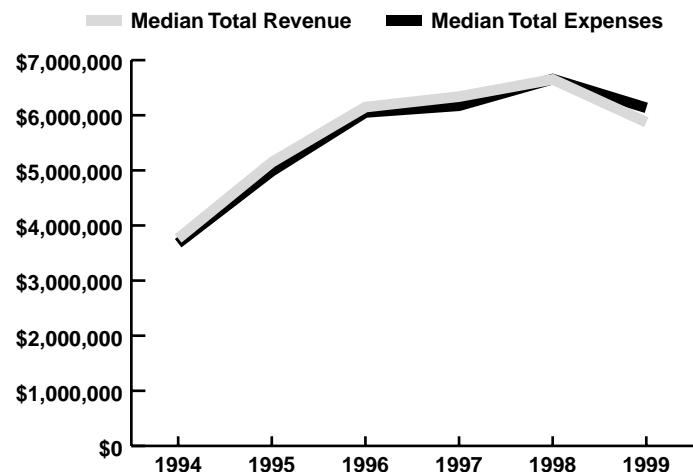
While the rate of growth of operating expenses declined, it exceeded the rate of growth of operating revenue during this period. By FY99, for the first time, median operating expenses were higher than median operating revenues (see Figure 2 above). Over time, having higher median expenses than median revenues is not sustainable.

### Liquidity

Liquidity is a measure of how readily the industry can generate cash for normal business operations. For the community health center industry, looking at these indicators over time may show how well the industry is able to cover its daily expenses and short-term debt obligations.

The current ratio measures a community health center's ability to cover present liabilities using current assets. From FY94 to FY99, the median current ratio fluctuated somewhat and

**Figure 2: Median Revenues and Expenses for Freestanding Massachusetts CHCs (FY94 - FY99)**



decreased overall (ranging from 1.89 to 2.50). While the median current ratio for the CHC industry has decreased overall, the CHC indus-

try maintains the ability to cover present liabilities using current assets.

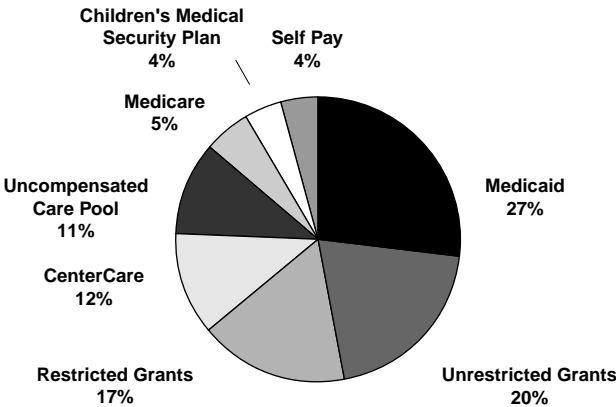
Days to patient accounts receivable, a measure of liquidity which represents cash that is unavailable for use in daily operations, remained fairly stable from FY94 to FY99 (range from a median of 63.5 to 69.3 days).

Payment period measures the number of days it takes for CHCs to pay their current liabilities. Like days to patients accounts receivable, median payment period from FY94 to FY99 held fairly steady (ranging from 53.0 to 58.0 days).

As CHCs become less liquid, meeting current obligations becomes more difficult which in turn jeopardizes their credit standing. Note that 43% of CHCs had payment periods over 60 days for FY99, a decrease from 50% in FY98, but an overall increase from 33% in FY94. These data indicate that a significant proportion of CHCs are having trouble meeting their current obligations in a timely manner.

indicate greater risk because total debt is a greater proportion of net assets. A leverage ratio

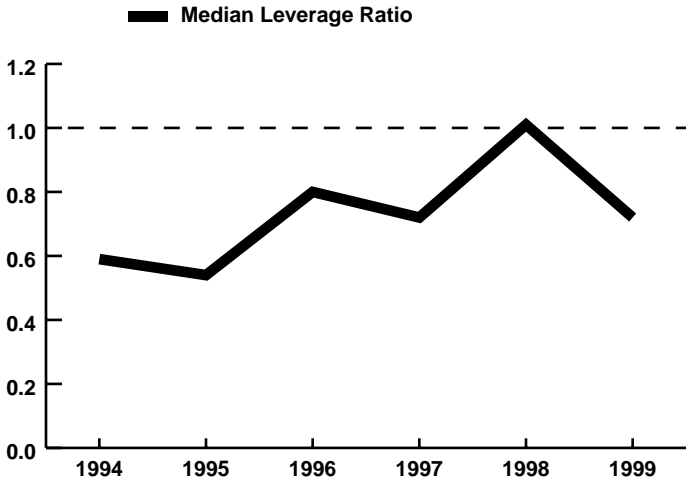
**Figure 3: Percent of Revenue for Freestanding Massachusetts CHCs (FY00)**



of 1.00 indicates that total liabilities equal net assets.

From FY94 to FY98 the median leverage ratios for CHCs increased from 0.59 to 1.01, indicating that by FY98 median total liabilities exceeded median net assets (see Figure 4 below). However, for FY99, the leverage ratio for Massachusetts CHCs fell to 0.72.

**Figure 4: Median Leverage Ratio for Freestanding Massachusetts CHCs (FY94 - FY99)**



### Debt

The leverage ratio measures the ratio of total liabilities to net assets. Higher leverage ratios

### Conclusion

The financial stability of the Massachusetts CHC industry was significantly impacted during the FY94-FY99 period. While the proportion of CHCs experiencing negative margins increased, CHCs maintained their ability to generate cash for operations. In addition, their ability to make and receive payments did not change significantly during this period.

Expenses incurred by CHCs grew faster than revenues during the five year period from FY94 to FY99 causing margins to decrease.

This may have been due to funding sources which did not keep pace with increases in expenses, particularly for labor and technology.

#### DHCFP Mission

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- collecting and analyzing data from throughout the health care delivery system;
- disseminating accurate information and analysis on a timely basis;
- facilitating the use of information among health care purchasers, providers, consumers and policy makers; and
- ensuring access to health care for low-income uninsured and underinsured Massachusetts residents through thoughtful administration of the Uncompensated Care Pool.

#### Analysis in Brief

*Analysis in Brief* reflects the DHCFP mission to monitor changes in the health care marketplace through useful and timely analyses of health care data. Several times a year, this publication reports on our analyses of health care costs, quality and access.



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As a result, the level of debt incurred by CHCs increased during this period. While FY99 saw some recovery, from FY94 to FY98 the level of debt incurred by CHCs nearly doubled.

Finally, a key feature of the financial health of community health centers lies in their grant

revenue (see Figure 3 on page 3). Much of this funding is restricted, and as a result, can only be used for certain expenses. This limits the flexibility of CHCs to subsidize losses in certain areas of operation with revenues in other areas.

1. [http://www.massleague.org/what\\_are\\_chcs.htm](http://www.massleague.org/what_are_chcs.htm)
2. Not financially affiliated/managed with a hospital, a freestanding CHC has its own separate 501(c)(3) and governing Board of Directors, is licensed by the Department of Public Health, and has a provider agreement with the Division of Medical Assistance.
3. Based on audited financial statements, the share of grants in total revenues was even greater in FY99 (45%) and in FY98 (47%).



The Division of Health Care Finance and Policy (DHCFP) recently launched an electronic newsletter—eDHCFP. This new and timely resource offers current information on the activities of the Division and its web site, including hyper links to web pages. Recent topics

include: health plan report cards, Congestive Heart Failure Demonstration Project, FY00 uninsured survey data, development of the Massachusetts Emergency Department Database, Elder Care Grant awards, information from the Health Care Task Force and maps showing the location of Massachusetts hospitals. This free resource—intended for journalists, policy makers, researchers, community groups and other interested parties—gives subscribers a quick look at what's new at the Division. To subscribe, visit the DHCFP web site at [www.state.ma.us/dhcfp](http://www.state.ma.us/dhcfp) or contact the Division's Office of Communications at 617-988-3125.

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